

## SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

**MODULE:** Business Value, Governance and Risk (BG)

**EXAMINATION DATE:** 22 December 2020

### General comments

The December 2020 BG examination consists of single case study with financial and industry data covering four questions, consistent with prior examinations.

The case study involves a medium-sized private company which operated in the Singapore restaurant sector. It operated a chain of twenty-five popular restaurants and has created a higher-end brand with high customer recognition. The company is considering moving from private to public ownership and listing on the Singapore Exchange (SGX). As a result, the Directors of the company are focused on that and there has been less time for Board oversight on the current operations in the short term.

Governance and Risk's learning outcomes are covered by questions 1 and 4. Question 1 covered on risk and control assessment and Question 4 required Candidates to complete a corporate governance analysis of existing governance practices and make recommendations should the company shifts from private to public ownership.

Business valuation's learning outcomes are covered by questions 2 and 3. Question 2 is on financing analysis, discussion and decision on whether to lease or buy equipment. Question 3 required determining a suitable price to take the company from private to public ownership and list the company shares on SGX by completing four valuation techniques.

Overall, Candidates' performance on the numerical elements of the examination were better than the discussion requirements. The main advice to future Candidates is respond to each requirement explicitly in order to access all the available marks. Further analysis and advice for future Candidates is given below.

### **Question 1**

Question 1 focused on the risk element of the syllabus and **part (a)** required Candidates to identify seven risks which SPDL restaurant operations are exposed to. For each risk, explain the risk identified and evaluate the expected likelihood and impact, which is a key guidance of most risk management frameworks, including COSO. The quality of response from Candidate was mixed. Many Candidate responses could have been improved by:

- 1) using evidence contained in the scenario, which on the whole wasn't well utilised; and

- 2) using judgement to explain the expected likelihood and impact sufficiently and separately.

However, some Candidates explained generic risks. Whilst these were awarded marks in some cases, the advice to future Candidates is to use risk evidence from the case.

**Part (b)** required Candidates to suggest a control activity in response to each risk explained in **part (a)**. Whilst many Candidate answers described a feasible control, some recommendations lacked practicality or detailed explanation of an activity which a restaurant could implement in practice to reduce each risk.

### Question 2

**Part (a)** focused on the financing on substantial new plant and equipment with a lease vs buy calculation which was largely done well. Most Candidates were able to provide separate lease versus buy calculations. In completing the lease vs buy calculations, a higher than anticipated number of Candidates did not demonstrate the technique to forecast future exchange rates using interest rate parity which affected the numerical accuracy of the overall result. Also, the majority of Candidates did not conclude effectively by either not quantifying the financial difference between the lease and buy decision to compute the cost saving, or did not provide non-financial factors which should always be considered alongside a financial result.

**Part (b)** required Candidates to discuss five benefits of lease financing. Generally, most Candidates fell short of explaining five different points. Some Candidates provided duplicate points, irrelevant points or provided points which stated a perceived benefit but failed to explain this benefit.

**Part (c)** was not answered well, with most Candidates were unable to compare different forms of debt financing which in this case was between a bank loan and a corporate bond. Many Candidates provided generic points applicable to all debt finance, or suggested points where the opposite was true in reality.

Responses to the discussion marks in Question 2 suggested that most Candidates had a greater understanding of the numerical aspects of debt financing than the understanding on key advantages and disadvantages of each form of debt. This is a recommended area for improvement for future Candidates as discussion of sources of finances will continue to be an examination area.

### Question 3

Question 3 required Candidates to prepare a range of valuations for the purposes of determining an issue price for a potential listing of SPDL on SGX.

**Part (a)** required Candidates to determine the weighted average cost of capital, and this was reasonably done well by most Candidates. However, some Candidates failed to adjust a similar listed beta by de-gearing and re-gearing to SPDL's gearing level.

**Part (b)** required the completion of four valuation methods requested by the Directors of SPDL. The net assets valuation, dividend valuation and earnings valuation methods were generally done well, with most Candidates correctly adjusting the listed PE ratio provided. The free cash flow valuation was also generally done well by most Candidates with the two main areas for improvement being:

- 1) adjusting for post-tax interest to cashflows; and
- 2) deducting debt from market capitalisation to determine the value of equity.

**Part (c)** required a critique of the Directors' assumptions included in the case. This requirement was competently performed by most Candidates. However, some Candidates duplicated points or simply re-stated the Directors' assumption provided without discussing its reasonableness.

**Part (d)** required Candidates to use their valuations from **part (b)** to suggest a suitable issue price for SPDL to list on the SGX. The majority of Candidates provided a reasonable calculation but did not adequately explain the suitability of the issue price provided.

#### Question 4

**Part (a)** required Candidates to explain the importance of the three tenets of corporate governance (accountability, transparency and sustainability). Whilst the definitions were provided by most Candidates, the majority of Candidates failed to apply these principles to SPDL and specifically in the scenario context of a private company listing on the stock exchange for the first time. The final paragraph of the case included a statement from SPDL's Financial Director to consider the three tenets if SPDL proceeded with the listing which was ignored by most Candidates in their answers. Future Candidates are advised to use the context of the case to substantiate their answers, not to expect solely theoretical requirements and to expect scenario-based knowledge application in all BG exam requirements.

**Part (b)** required an explanation of the 'comply or explain' rule and the impact on SPDL after it has listed on SGX. The theoretical definition of 'comply or explain' was adequately provided by most Candidates. However, a few Candidates explained the practical implications on a newly listed company which doesn't currently fully comply with the code. Most Candidates did not explain the need for SPDL to disclose on listing on SGX, how it intended to meet current non-compliance of specific provisions of the code to become fully compliant and consider the potential reaction of investors if they do not believe that SPDL's explanations are credible.

**Part (c)** was the best attempted part of Question 4 which focused on practical examples of non-compliance with the code of governance evidenced in the case. Most Candidates were proficient in explaining a relevant provision of code using evidence from the case where SPDL was not currently compliant. However, some Candidates failed to fully use all the evidence of non-compliance provided in the case, such as the named non-independent Directors, and instead provided generic responses or assumed non-compliance points which were not referenced in the case, which scored less well.

Future Candidates are advised to utilise information included in the case as this is often carefully crafted. Also, future Candidates are advised to be precise and detailed when providing practical recommendations.